



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

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Date	02/20/13	Bill No:	<a href="#">Assembly Bill 576</a>
Tax Program:	Administration	Author:	V. Pérez
Sponsor:	BOE Chairman Horton	Code Sections:	GC 15910 - 15924
Related Bills:		Effective Date:	01/01/14

***This analysis only addresses the provisions that impact the BOE.***

## BILL SUMMARY

This bill creates a multiagency partnership among the Board of Equalization (BOE), Franchise Tax Board (FTB) and the Employment Development Department (EDD) to combat illegal underground economic activity related to underreporting of state tax obligations and other violations of state law. The proposed Centralized Intelligence Partnership (CIP) creates a central intake process and an organizational structure to document, review and evaluate data and complaints associated with this activity.

## ANALYSIS

### CURRENT LAW

Currently, various joint agency enforcement programs have been established to combat the underground economy. These include the Joint Enforcement Strike Force and the Economic and Employment Enforcement Coalition (EEEC). In January 2012, the EEEEC was consolidated into the Department of Industrial Relations to form the Labor Enforcement Task Force (LETF). Additional individual agency efforts include the BOE's Statewide Compliance and Outreach Program and the Contractor State License Board's Statewide Investigative Fraud Team.

### PROPOSED LAW

This bill adds and repeals Section 12.2 (commencing with Section 15910) to Division 3 of Title 2 of the Government Code to establish the CIP as a pilot program. The proposed CIP includes the BOE, FTB, and EDD and serves as a centralized information intake center for strategic planning, as well as data sharing and analysis. The CIP would investigate organized criminal entities and/or serial offenders for violation of labor, tax, and other laws.

The following agencies could also participate in the CIP in an advisory capacity:

California Health and Human Services Agency

Department of Consumer Affairs

Department of Industrial Relations

Department of Insurance

Department of Justice

Department of Motor Vehicles

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An advisory committee comprised of one representative each from the BOE, FTB, and EDD will direct the CIP activities. Each participating agency or department will appoint an advisory committee representative to serve at the pleasure of the appointing authority. The advisory committee provides guidance regarding the activities and operations of the CIP. Agencies participating in an advisory capacity can provide an advisory committee representative to offer guidance and advice to the partnership.

Additionally, this bill will:

- Establish a processing center to receive and analyze data, share complaints, and research leads from the input of each impacted agency.
- Allow authorized partnership representatives to exchange intelligence, data, documents, information, complaints, or lead referrals, related to illegal underground operations, notwithstanding any other law.
- Provide participating and nonparticipating entities value-added investigative leads to collaborate on felony-level criminal investigations.
- Allow each participating and nonparticipating agency to retain jurisdictional authority over investigations. Each agency determines whether to pursue partnership strategies or collaborative investigative leads.
- Provide that participating entities document and provide intake data analysis, analytic data findings, referrals, emerging evasion trends, lessons learned, as well as additional enforcement, administrative, and legislative opportunities.
- Require the CIP to report to the Legislature on or before July 1, 2015, and annually thereafter, on its activities and accomplishments. All participating agencies will receive the report.
- Require the CIP to provide a report to the Legislature by December 1, 2017, on the number of complaints processed and cases investigated or prosecuted.

This measure also calls for the advisory committee to the CIP to:

- Determine the appropriate agency to house the central intake and processing center, and
- Hire an administrator and staff.

However, funding is not provided in this bill. The scope of activities and projects undertaken will be consistent with the funds appropriated by the Legislature.

This proposed statute would sunset on January 1, 2019.

#### **IN GENERAL**

The underground economy refers to those individuals and businesses that deal in cash and/or use other schemes to conceal their activities, identities and their true tax liability. Activities range from the sale of stolen or counterfeit product to the exploitation of human trafficking victims.

Last year's [SB 1185](#) (Price) was similar to this bill. That bill died on the Assembly Appropriations Committee's suspense file.

**COMMENTS**

1. **Sponsor and Purpose.** BOE Chairman Horton is sponsoring the creation of the CIP as a collaborative, strategic, and focused effort to combat the underground economy through comprehensive data and resources analysis. He envisions a synergy among the various enforcement agencies that addresses issues which impact California industries. This collaborative effort is intended to significantly increase the efficiency and effectiveness in recapturing revenue lost to illegally operating businesses, thereby resulting in a more robust, legitimate economy.
2. **The underground economy hurts all Californians.** Those who operate in the underground economy enjoy the same public services as tax and fee payers without making the same contributions
3. **Underground economic activities span across multiple jurisdictions.** Many collaborative efforts are already underway in which investigators periodically meet to discuss current investigations, team up to conduct sting operations, and collaborate on best practices. However, despite these significant efforts, California continues to lose revenue due to the underground economy.
4. **The CIP will focus on criminal prosecution.** Minor and inadvertent violations by businesses will be addressed through other administrative procedures.

**COST ESTIMATE**

The bill envisions a phased-in implementation approach. Staff of 5 PYs is needed to allow the BOE to meet the requirements of the bill. The BOE will incur costs of approximately \$245,000 in fiscal year (FY) 13-14, \$584,000 in FY 14-15, and \$679,000 in each ongoing fiscal year.

**REVENUE ESTIMATE**

BOE internal data indicate that its Investigations Division worked 16 cases related to the underground economy in FY 2010-11, yielding an additional \$12.6 million in combined tax, interest and penalties. In FY 2011-12 the Investigations Division worked 12 cases yielding an additional \$7.9 million in tax, interest and penalties combined. We assume that the new positions associated with the CIP will enhance efficiencies for all participating agencies, including BOE. Moreover, our research indicates that cooperative enforcement activities allow the leveraging of resources so that BOE could expand its capabilities to larger cases that provide higher recovery per investigative hour. We specifically assume that the CIP will allow BOE's Investigations Division to increase its collections by 120 percent of the combined average of the FY 2010-11 and FY 2011-12 figures, approximately \$12.3 million once fully implemented. We also believe that increased voluntary compliance associated with the CIP will result in an additional \$3 million of revenue for a total revenue increase of \$15.3 million once fully implemented.

Under a proof of concept plan, BOE investigators reviewed EDD employment data for one industry group in several California geographic areas. In addition to identifying potentially fraudulent activity, the data provided new high-value leads for administrative audit and collection activities. Staff reviewed EDD information for 1,947 accounts from a population of 32,588 restaurant businesses in the Los Angeles and San Diego areas. Two accounts were found not to have sellers' permits. An industry standard

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comparison of salary wages to gross receipts indicates that restaurant salaries and wages average 18.33% for corporations and 27.25% for sole proprietors. For estimation purposes, 25% was used for the bill.

1) Total salaries and wages for the two businesses	\$125,238
2) Salary and wage percentage	25%
3) Estimated unreported gross sales (Line 1 / Line 2)	\$500,951
4) Reported gross sales for sample group over 3 years	\$3,792,150,032
5) Error Percentage (Line 3 / Line 4)	0.01%
6) Total gross sales for population	\$75,906,365,794
7) Project unreported tax for the population (Line 6 x Line 5)	\$7,590,637
8) Estimated unreported tax (\$7,590,637 x 7.25%)	\$550,321

Based on the preceding calculation, we estimate that the first year's revenue increase will total \$550,321. The revenue increase for the second year will double to \$1.1 million.

Pursuing these high-value administrative leads will allow the BOE to achieve new revenue in the first and second years of the CIP, with revenue from criminal investigations in the third year.

Accordingly, we estimate that associated sales and use tax revenues will increase by approximately \$550,000 in FY 13-14, \$1.1 million in FY 14-15, and up to \$15.3 million annually once fully implemented.

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